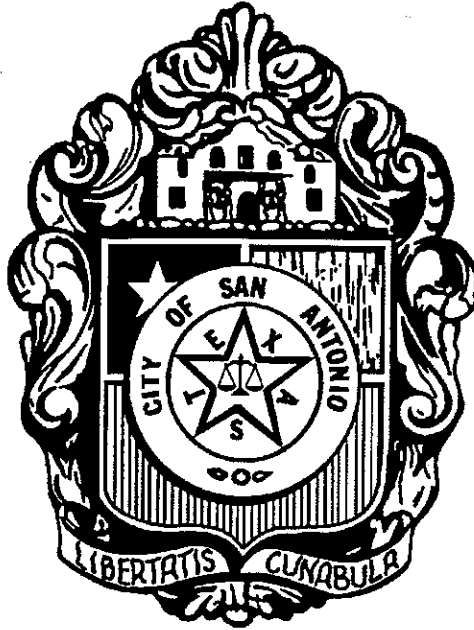


# **Convention Center Hotel Advisory Board**



## **May 2004 Report**

## Project Background

The City of San Antonio seeks to strengthen its position among the nation's leading convention destinations and continue to develop the downtown area as one of the leading cultural, entertainment, and commercial centers in the United States.

As such, the City has been pursuing qualified developers capable of developing a premier, full-service convention center hotel adjacent to the Henry B. Gonzalez Convention Center.

The development site contains more than 118,000 square feet and is ideally located at the north entrance of the Convention Center, along the San Antonio Riverwalk and wraps around the Lila Cockrell Theater (pictured).

The proposed hotel will accommodate additional conventions, convention delegates and maximize the utilization and return on investment of the Convention Center as well as enhance utilization of existing hotel rooms through growth in convention business and visitor industry activity.



## Respondents to City's Request for Qualifications

In 2002, the City issued a Request for Qualifications (RFQ) to a broad list of nationally recognized development companies. It was the City's intent to identify qualified developers that were interested in pursuing the project. Five developers responded to the RFQ.

- Hines Interests, LP
- Landmark/FaulknerUSA
- Mesirow Stein
- Related Lodging
- Ryan Companies

Since that time, representatives of Mesirow Stein have informed the City that the company no longer intends to pursue the project. The four remaining companies continue to express interest in the project.

## Convention Center Hotel Advisory Board

In February 2003, the City Council established the Convention Center Hotel Advisory Board (CCHAB), which is composed of seven local experts from the Finance/Banking, Real Estate/Corporate, and Hotel/Tourism business sectors as well as a community representative.

After becoming familiar with the project and financing issues, it was envisioned that the CCHAB could assess and make recommendations to the City Council on the following topics:

- Developer capabilities
- Project financial design
- Project timing

In March 2003, the City Council appointed the following individuals to the CCHAB:

Finance/Banking

Ruben M. Escobedo  
Adam Garza  
Joe C. McKinney

Real Estate/Corporate/Hotel

Henry Feldman  
Juli Galloway  
*Vacant*

Community

Richard Terrell

The Board selected Ms. Galloway as Chair, and Mr. McKinney as Vice-Chair. Msrs. Escobedo and Garza stepped down from the CCHAB in 2003.

### **Advisory Board: Fact-Finding Phase**

Since April 2003, the Advisory Board called on City staff from the Economic Development and Finance Departments, Convention and Visitors Bureau, and the City Manager's and City Attorney's Offices, as well as hotel consultants, the City's financial advisors, industry experts and bond underwriters. The Advisory Board deliberated on the following five issues:

1. Need for another convention center hotel;
2. Viability of a new hotel;
3. Ideal scope of the hotel;
4. Potential cost of development; and
5. Project financing options.

Additionally, the CCHAB members have traveled to Houston to tour the new 1,200-room *Hilton Americas* to understand current trends in convention center hotel development. The Advisory Board also met with key officials involved in the development of that project, including former Houston Mayor Bob Lanier.

## **Issue 1: Is a Convention Center Hotel Needed?**

The strength of San Antonio as a meetings destination includes the appeal of a diverse array of things to see and do, major attractions, history, culture, golf, cuisine, arts, and other elements that include a fun and friendly atmosphere.

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Planners have cited the central U.S. location; mild year-round weather; and critical mass of centrally located and functional meeting facilities, hotels and attractions. There is also limited need for shuttles/busing since the city has great walk ability and accessibility. The newly renovated airport services key domestic and international destinations, and its close proximity to downtown provides for easy and inexpensive transport.

According to the San Antonio Convention and Visitors Bureau (SACVB), meeting planners consistently point to their desire to place more delegates (in larger blocks) at fewer hotel properties. In addition, many of the City's core convention clients continue to grow their association memberships. Larger meetings not only require an expanded center, but the availability of larger blocks of hotel rooms.

Other Texas cities are developing new hotel properties that already are providing direct competition to San Antonio as a regional convention destination. These projects include:

- Austin Hilton Hotel, 800 rooms  
*Opened December 2003*
- Houston Hilton Americas, 1,200 rooms  
*Opened December 2003*
- Grapevine Gaylord Texan Hotel, 1,511 rooms  
*Opened April 2004*

The proposed convention center hotel goes hand-in-hand with the investment the City has already made in the expanded and renovated convention center, and will strengthen the ability to sell San Antonio. Moreover, many convention clients require that their meetings be held in a single hotel and San Antonio is often eliminated from consideration because of its inability to provide a property or more than one property of suitable capacity. The construction of the hotel adjacent to the Convention Center would create a competitive advantage for San Antonio in its marketing efforts, as it would be in the unique position of having over 3,000 full-service hotel rooms within one-block walking distance.

#### **Recommendations/Next Steps:**

Despite all the city's advantages, San Antonio operates in an extremely competitive meetings business environment, and must continually improve its product offerings in order to retain and increase market share. As a result of these attributes, the Board has concluded that a convention center hotel is vital to the continuing success of San Antonio as a competitive meeting destination.

#### **Style/Design**

The design of the convention center hotel should be of a style and quality to meet and exceed that of recent new similar projects that have been constructed. There should also be connectivity in design with the convention center. The specific design should

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complement the atmosphere and positioning of the overall destination and should contain some design elements of our unique and indigenous destination qualities.

### **Marketing Dollars**

It is imperative that an appropriate amount of marketing dollars be anticipated in order to aggressively promote the enhanced new product that the SACVB will be selling. The selected hotel company will focus primarily on direct hotel marketing while the SACVB will need to reintroduce the San Antonio product with the addition of this new property and other product enhancements (other new hotel construction and renovations, attractions, etc.). This should be considered in the upcoming FY2005 budget cycle since it is tentatively planned that an announcement on the selected hotel flag would occur during FY2005.

## **Issue 2: Is the Project Viable?**

The City's previous hotel consultant, PKF Consulting, was asked to conduct a project feasibility study, in 2002. Based on research of the competitive lodging market, PKF concluded that a full-service convention center hotel of up to 1,500 rooms could be viable.

Following its selection in March 2004, HVS International conducted an updated market feasibility study, assuming a 1,000-room property, which reflects current market conditions. HVS estimates that the hotel could stabilize in the fourth year of operation (2011) with occupancy of 73 percent and average daily rate (ADR) of \$180 (expressed in 2011 dollars).

Both consultants believe that the introduction of a new convention center hotel will increase demand for hotel rooms, which reflects an amount of pent-up demand not being met, as well as make San Antonio even more attractive to prospective convention delegates from a price standpoint.

The Advisory Board also examined the overall state of the convention industry to assess the long-term growth of demand for hotel rooms at both a national and local level. A variety of other reports from City Staff and industry experts were provided to the Advisory Board.

### **Recommendations/Next Steps:**

The Advisory Board has determined the project is viable, but that a 1,500-room hotel would be too risky for the City to pursue as a development objective given current market conditions and possible municipal requirements for project financing. The Board instead recommends that the project scope not exceed 1,200 rooms, with emphasis on a property of 1,000 rooms.

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In considering hotel-financing scenarios, the Advisory Board heard from the City's financial advisor, Coastal Securities, on the critical balance between hotel size and possible financial risks to the City. The Advisory Board believes that the City's project goals must be tempered by market and financial concerns when determining the ideal size for the proposed hotel. For these reasons, the Advisory Board believes it would be more prudent for the City to develop a convention center hotel of 1,000 guestrooms.

### **Issue 3: What is the Ideal Scope of the Hotel?**

This is not just another hotel project for San Antonio. It is a critical component of infrastructure for the meetings industry. It will allow the SACVB to market the City, as it never has before. As such, the hotel should be a signature project that will enhance the City's status as a leading convention destination.

#### **Recommendations/Next Steps:**

In order to meet certain minimum standards that would attract conventions and keep the city competitive with other leading destinations, the Advisory Board concurs that an ideal hotel project should include:

- Approximately 1,000 hotel guestrooms;
- First-class, full service amenities;
- Large capacity meeting and food and beverage facilities (minimum 90,000 square feet to include a 40,000-square foot ballroom and/or a 25,000-square foot junior ballroom);
- Adequate size parking garage for general public and hotel use;
- Nationally recognized hotel operator;
- Premier national and international marketing and sales operation;
- Room block agreement for approximately 800 rooms;
- Hotel employees paid a living wage as defined by City Council;
- Convenient and easily accessed interface with Riverwalk and Convention Center.

### **Issue 4: What is the Cost of Development?**

In today's market, a first-class premier convention center hotel would cost at least \$215,000 per room to design, construct and furnish.

#### **Recommendations/Next Steps:**

Using this rule of thumb, a 1,000-room hotel would cost \$215 million. However, there are additional and significant financing expenses that are **not** included in this figure. These additional financing costs may range from \$40,000 to \$75,000 per guestroom.

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## **Advisory Board: Financial Structure**

### **Issue 5: What are the Project Financing Options?**

In December 2003, the City of San Antonio selected Citigroup and UBS as underwriters to serve the Advisory Board in reviewing project financing options. These firms have actively participated in other municipal hotel financings. The following information summarizes the three financing options for a hotel.

#### **I. Private Ownership: 100% Private Financing**

- Owner/operator provides equity
- Debt is raised via banks or capital markets, by owner
- May include public incentives such as tax abatements

#### **II. Private Ownership: Public Sector Assistance**

- Owner/operator provides equity
- Some debt is raised via banks or capital markets, by owner
- Financing “gap” remains after equity and available private debt are determined
- Public sector is needed to provide subsidy in the form of public debt financing

#### **III. Public Ownership: Public Financing using Tax-Exempt Bonds**

- Host municipality establishes Hotel Corporation or such entity to own/operate hotel
- Corporation contracts with hotel manager to operate hotel for “fixed” annual fees
- Corporation selects developer or project manager to build facility
- Corporation issues tax-exempt bonds to finance construction
- IRS regulations do not permit a private sector party to invest equity or receive “equity-like” returns

#### **Recommendations/Next Steps:**

The Advisory Board received reports indicating that conventional hotel financing would be difficult to achieve. According to financial advisors and financial underwriters, some form of municipal or non-profit debt financing will be required to bridge the gap between financing provided by the developer and total construction costs to ensure development. While the net operating income from the hotel is projected to cover operating and debt service costs in normal years, under certain adverse circumstances the City could be expected to pay some or all of the debt service payments with pledged revenue sources during years in which net operating revenues are insufficient or the private hotel owner's obligation is not met to pay all debt service payments. As a matter of policy, the

Advisory Board recommended that the City seek as much private equity contribution as possible to minimize the amount of the City's long-term risk.

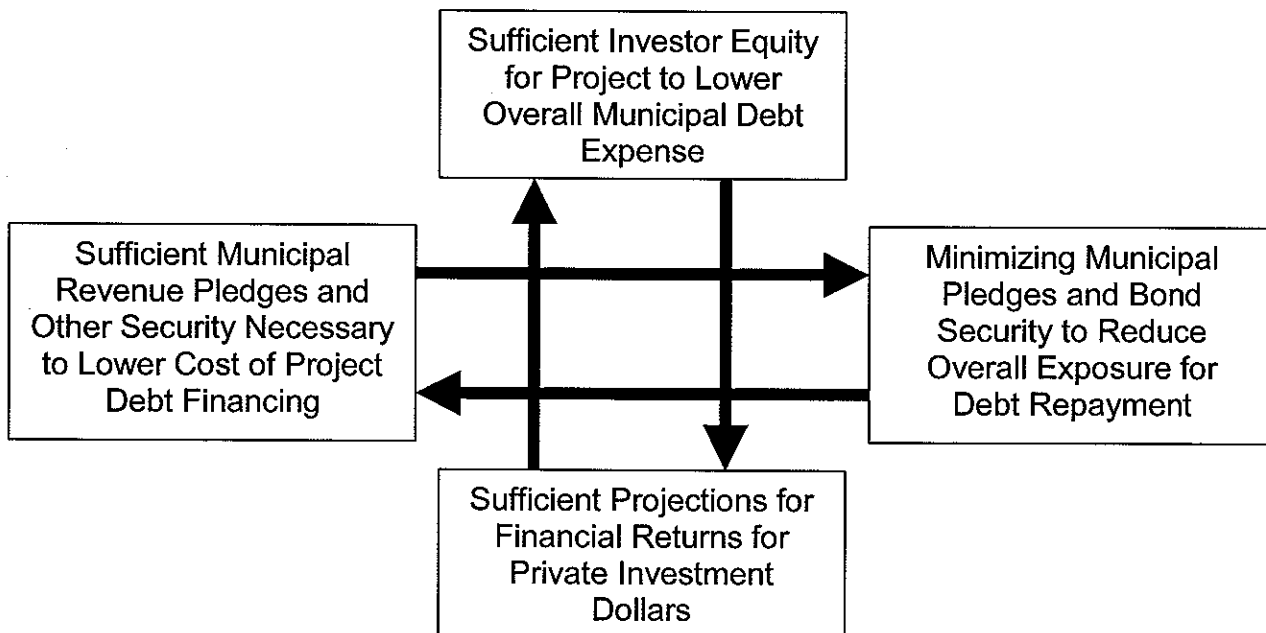
Moreover, the Advisory Board strongly believes that the option of public ownership be avoided if at all possible. In balancing the financial and strategic considerations, the Advisory Board has recommended a program that meets the potential of the market, and attracts private capital investment to the project.

Public ownership would require on-going asset management responsibilities by the City staff or non-profit corporation for an industry/service with which the City is largely unfamiliar. Additionally, public ownership would place additional financing risks on the non-profit owner that would not necessarily be imposed if owned privately.

### Issue 6: What is the Preferred Financial Structure?

The CCHAB worked with the financial team to balance three goals:

- To attract sufficient private and/or public project financing to develop the hotel.
- To minimize the overall financing costs for the project by reducing total project debt and using credit pledges to lower overall interest rates. This will, in turn, lower cash flow requirements required to pay debt service, while providing for adequate investment returns to private investors.
- To minimize long-term financial risks to the City from necessary municipal credit enhancements and revenue pledges, which otherwise might impact the hotel occupancy tax (H.O.T.) funded activities.



**Recommendation/Next Steps:**

The financial team reviewed over 16 financing structures, taking into consideration these goals, debt instruments, and interest expenses. After extensive discussion, the consensus recommendation of the CCHAB is that the following be pursued as the "preferred financial structure:"

**Sources of Project Financing, as follows:**

- > Private Investor Equity (minimum 20% of project costs)
- > Tax-exempt Empowerment Zone bonds (max. up to \$130 million)
- > City-provided debt (taxable, private activity bonds)

The Advisory Board, staff, and consultants have been very concerned about the type of revenue pledges that the City might make to support financing for a hotel. One goal from the outset of the Board's work has been to minimize any impact of stand-by financial pledges of Hotel Occupancy Taxes (H.O.T.), which are used primarily to fund operations of the convention facilities, as well as, the operations and advertisements of the Convention and Visitors Bureau and other H.O.T.-supported activities.

As such, the recommended payment of the City-provided hotel financing should occur using the following sources:

1. Hotel net operating income (room sales, food, beverage, parking, leases, etc.)
2. If not sufficient, then additional capital provided by investor owners to pay annual debt service from note to City.
3. If not sufficient, then pledged State H.O.T. generated by project (for first 10 years of operation, only).
4. If not sufficient, then pledged State sales taxes generated by project (for first 10 years of operation, only).
5. If not sufficient still, then City H.O.T. (7%) revenues generated only at the project (subordinate to payment of certain outstanding convention center revenue bonds).
6. If not sufficient, then from City 2% *convention facilities H.O.T.\*\** (only) revenues collected from across City (subordinate to payment of certain outstanding convention center revenue bonds).

\*\* - The 2-percent convention facilities H.O.T. is permitted by State law for the sole use of financing or improving a convention facility, and can include this hotel. In other words, the convention facilities 2-percent H.O.T. **cannot** be used for local purposes, such as advertising, marketing, or arts funding.

Based upon recommendations of HVS International, the Advisory Board recommends that all developers be required to respond to a future proposal assuming the preferred financial structure, preferred hotel scope, and common set of hotel performance assumptions, as developed by HVS. Alternative proposal regarding financial structure or development scope could be accepted, but would require more extensive analysis to determine worthiness against the preferred approach.

## **Issue 7: Selection of A Preferred Developer**

Presently, four qualified developers have expressed interest in this project. To gather additional information to evaluate and determine the most qualified and preferred developer for this opportunity, a proposal process is envisioned. HVS International is developing a request for proposal document (RFP) for this purpose.

### **Recommendation/Next Step:**

While it may be possible to attract additional developers to submit a project proposal, the CCHAB recommends that the next stage of the developer selection process be limited to the four remaining original respondents.

Additionally, the CCHAB recommends that the hotel operator (e.g., Hyatt, Hilton, Marriott, Sheraton, Westin, etc.) not be identified during the developer proposal phase. While an operator brings value to the community and project in several ways, the City and developer should jointly conduct a competitive process for the operator to maximize that value soon after the developer selection is made.